

Seminar for Bank Branch Statutory Auditors

Prudential Norms on Income Recognition,
Asset Classification and Provisioning

Organised by: Ernakulam branch of
SIRC of ICAI

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Coverage

- Objective
- Identification of Account as NPA
- Exceptions / Clarifications
- Projects under Implementation
- Asset Classification and Provisioning
- Guidelines on Restructuring of Advances
- Early recognition of financial distress
- Strategic Debt Restructuring (SDR)
- Scheme for Sustainable Structuring of Stressed Assets (S4A)
- Resolution of Stressed Assets
- Points to ponder

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RBI Circulars Reference

- Master Circular dated July 01, 2015 on IRAC Norms
 - Part A – General Guidelines
 - Part B – Prudential Guidelines on Restructuring
 - Part C – Early recognition of financial distress
- Master Direction – RBI (Relief Measures by Banks in Areas affected by natural calamities) Directions, 2018 dated October 17, 2018
- Resolution of Stressed Asset – Revised Framework – Circular dated February 12, 2018
- Relief for MSME Borrowers : 07.Feb.2018, 08.Jun.2018 & 01.Jan.2019

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Objective

- The classification of assets of banks has to be done on the basis of objective criteria, which would ensure a uniform and consistent application of the norms.
- The provisioning should be made on the basis of the classification of assets based on the period for which the asset has remained non-performing and the availability of security and the realisable value thereof.

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Asset Types

Standard Assets Performing Assets (PA)	Non-Performing Assets (NPAs)
Not Non-Performing	Ceases to generate income
Do not carry risk more than normal banking risk	Higher risk than normal banking risk
	NPA as per various criteria defined

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Criteria for NPA

Loans or Advance	<ul style="list-style-type: none"> ▪ Interest and/or installment remains overdue for a period of more than 90 days in respect of a term loan. ▪ <i>As per para 2.1.3, an account is classified as NPA only if <u>interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.</u></i>
Exceptions	<ul style="list-style-type: none"> ▪ Loans with moratorium for payment of interest ▪ Housing Loan or similar advance to staff

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Criteria for NPA	
Bills Purchased and discounted	Bill remains overdue for a Discounted period of more than 90 days.
Agricultural Advances	Interest or installment remains overdue for two crop seasons for short duration crop, one crop season for long duration crop.
	<i>*Definitions crop season – 'period up to harvesting of crops raised' as determined by SLBC Long duration crop – Crops wherein crop season is more than 12 months</i>
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Criteria for NPA	
Agricultural Advances	Banks have discretion of rescheduling the agricultural advances in case of natural calamities, which impair repaying capacity
Reference Circulars of Reserve Bank of India	FIDD.CO.Plan.BC.54/04.09.01/ 2014-15 dated April 23, 2015 FIDD.No.FSD.BC.52/ 05.10.001/2014-15 dated March 25, 2015 Master Direction dated July 01, 2016 Master Direction dated July 03, 2017
FIDD.CO.Plan.BC.54/04.09.01/ 2014-15 dated April 23, 2015	Defines 'Farm Credit'
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Criteria for NPA	
FIDD.No.FSD.BC.52/ 05.10.001/2014-15 dated March 25, 2015 Guidelines for relief measures by banks in areas affected by natural calamity	
Natural Calamity	12 types of natural calamities are defined
Institutional framework	The Banks to have blueprint of action plan with adequate delegation of powers with discretionary powers granted to Divisional / Zonal Managers, to ensure assistance provided without loss of time.
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Criteria for NPA	
Guidelines for relief measures by banks in areas affected by natural calamity	
Meeting of SLBC / District Consultative Committee	<i>Immediate conveying of meeting by:</i> If calamity covers entire state SLBC If small part of the state District Consultative Committee
Declaration of natural calamity	Domain of Sovereign (Central / State Government) <u>Assessed Crop loss should be 33% or more</u>
Restructuring / rescheduling of existing loans	Agricultural Loans - Short Term - Long Term Other Loans

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Criteria for NPA	
Guidelines for relief measures by banks in areas affected by natural calamity	
Short Term Agricultural Loans	
<i>Eligibility:</i> Loan should not be overdue at the time of occurrence of natural calamity	
<i>Crop Loss</i>	<i>Maximum repayment period extension (incl. of moratorium period)</i>
33% to 50%	2 Years
50% or more	5 Years
<ul style="list-style-type: none"> • Moratorium period – at least 1 year • Principal and interest due in the year of natural calamity to be converted into Term Loan • Additional collateral security not to be insisted upon 	

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Criteria for NPA	
Guidelines for relief measures by banks in areas affected by natural calamity	
Long Term Agricultural Loans	
<i>Only Crop for that year is damaged and not the productive assets</i>	
<ul style="list-style-type: none"> - Reschedule installment during the year of natural calamity and extension of loan period by one year - Willful defaulted installments not eligible for rescheduling - Payment of interest may be postponed 	
<i>Productive Assets are damaged (partially / totally)</i>	
Repayment period can be restructured provided generally it shouldn't exceed 5 years	

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Criteria for NPA	
<small>Guidelines for relief measures by banks in areas affected by natural calamity</small>	
Asset Classification	<ul style="list-style-type: none"> - Restructured portion to be considered as current dues - Un-restructured portion to be governed by original terms and conditions - Additional finance to be treated as 'Standard Asset' - Second restructuring would not be considered as 'repeated restructuring'
Insurance Proceeds	To be adjusted against restructured loans wherein fresh loans are granted

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Criteria for NPA	
Derivative Transaction	Overdue receivables representing positive mark to market value of a derivative contract remaining unpaid for a period of 90 days from specified due date.
Liquidity facility	Remains outstanding for more than 90 days in respect of Securitisation transaction.
Credit Card dues	The minimum amount payable is not paid within 90 days from the next statement date

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Criteria for NPA	
Cash Credit Accounts	If the account is 'out of order'
<u>Conditions for out of order status</u>	
<ul style="list-style-type: none"> ▪ Outstanding Balance remains continuously in excess of sanctioned limit / drawing power for more than 90 days ▪ No credit continuously for 90 days as on the date of Balance Sheet ▪ Credits in the account are not sufficient to cover interest debited during the same period 	

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Criteria for NPA

What is 'Overdue'?
If an amount due to bank under any credit facility is not paid on the <u>due date fixed</u> by the bank.

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Criteria for NPA

Accounts with Temporary Deficiencies
Outstanding Balance in account based on the drawing power calculated from stock statements older than 3 months would be deemed as irregular & if such irregular drawing are permitted for a period of 90 days, account needs to be classified as NPA
<i>Note: The leverage is <u>applicable only for large borrowers</u></i>
Non-renewal/ Non-regularisation of regular / adhoc limit within 180 days from the due date

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Criteria for NPA

Exceptions / Clarifications
<ul style="list-style-type: none">▪ Advances against term deposits, NSCs, IVPs, KVPs and Life Insurance Policies need not be treated as NPAs, till security cover is sufficient to cover outstanding balance.▪ Income to be recognised subject to availability of margin
Advance against gold ornaments / Government securities not exempt.
Central Government guaranteed advance to be classified as NPA only if Government repudiates the guarantee when invoked.

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Criteria for NPA

Exceptions / Clarifications
<p><u>Classification Qua Borrower</u> All facilities granted to a borrower shall be treated as NPA & not only that facility which has become irregular</p>
<p><i>Exception</i></p> <ul style="list-style-type: none"> (i) Credit facility to Primary Agricultural Credit Society (PACS) and Farmers Service Societies (FSS) under on lending arrangement; (ii) Bill Discounted against accepted LC

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Criteria for NPA

Exceptions / Clarifications
<p><u>Consortium Advances</u></p> <ul style="list-style-type: none"> ▪ Member banks shall classify the accounts according to their own record of recovery. ▪ Bank needs to arrange to get their share of recovery or obtain an express consent from the Lead Bank otherwise the account in such deprived banks might be treated as NPA for non-servicing.

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Criteria for NPA

Exceptions / Clarifications
<p><u>Straightaway Classification (Potential threat of recovery)</u></p> <ul style="list-style-type: none"> ▪ Erosion in Value Where realisable value of security is less than 50% of the value assessed (<i>by bank or value accepted in last RBI Inspection</i>), account to be straightaway classified as Doubtful Asset.. ▪ Where realisable value (<i>as assessed by Bank / Valuator / RBI Inspector</i>) of security is less than 10% of <u>outstanding balance</u>, account to be straightaway classified as Loss Asset.

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Criteria for NPA

Exceptions / Clarifications
<p><u>Straightaway Classification (Potential threat of recovery)</u></p> <ul style="list-style-type: none"> ▪ Fraud <li style="padding-left: 20px;">▪ 100% to be provided irrespective of security spread over 4 quarters commencing from the quarter in which fraud has been detected. <li style="padding-left: 20px;">▪ If not reported to RBI, 100% to be provided instantly

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Criteria for NPA

Exceptions / Clarifications	
<p><u>Solitary or few credit entries recorded before Balance Sheet to regularise the account</u></p> <p>Whether the account is having inherent weakness?</p> <div style="text-align: center;"> </div>	
Yes	No
Mark the account as NPA	The bank to evidence the auditors about manner of regularisation of account

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Criteria for NPA

Mandatory Valuation of Securities
<p><u>Applicable only if balance in NPA is Rs. 5 crores & above</u></p> <ul style="list-style-type: none"> ▪ Annual Stock Audit by external agencies ▪ Immovable Properties – Valuation to be carried out once in three years by approve valuer

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Criteria for NPA

Two quick questions

- In case of Term Loans, the account was having 4 instalments overdue during the year but is having only 2 instalments as at year-end Whether the account identification / classification is to be done only at year-end or during the year?
- The account is regularised after the year end either during the audit process or before signing of balance sheet of the bank

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Criteria for NPA

Quick Reference to Para 4.2.5

If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as non-performing and may be classified as 'standard' accounts.

Quick Reference to Para 4.2.2

The system should ensure that doubts in asset classification due to any reason are settled through specified internal channels within one month from the date on which the account would have been classified as NPA as per extant guidelines

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Relief for MSME Borrowers

Circular dated February 07, 2018

Eligibility:

- i) Borrower is classified as MSME under MSME Act, 2006
- ii) Registered under GST as on 31.Jan.2018
- iii) Aggregate exposure (FB/NFB) upto Rs. 25 crores
- iv) Account is standard as on 31.Aug.2017
- v) Prima facie Applicable only to TLs and not to CC/OD

Relief:

- i) 'Overdues' as on 01.Sep.17 to be paid not later than 180 days
- ii) 'Dues' between 01.Sep.17 & 31.Jan.18, to be paid not later than 180 days
- iii) Additional provision of 5% against such accounts

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Relief for MSME Borrowers

Circular dated June 06, 2018

Encouraging formalisation of MSME sector ...
Benefits extended to MSMEs not registered under GST

- i) Borrower is classified as MSME under MSMED Act, 2006
- ii) Aggregate exposure (FB/NFB) upto Rs. 25 crores as on 31.May.2018
- iii) Account is standard as on 31.Aug.2017

Relief:

- i) 'Overdues' as on 01.Sep.17 to be paid not later than 180 days
- ii) 'Dues' between 01.Sep.17 & 31.Dec.18, to be paid not later than 180 days
- iii) Additional provision of 5% against such accounts

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Relief for MSME Borrowers

Circular dated June 06, 2018

GST registered MSMEs, 180 days past due concept to be aligned IRAC norms (of 90 days) in phased manner

Due dates falling between	Time permitted
01.Sep.17 – 31.Dec.18	180 days
01.Jan.19 – 28.Feb.19	150 days
01.Mar.19 – 30.Apr.19	120 days
01.May.19 onwards	90 days

For MSME not registered under GST, IRAC norms applicable immediately with effect from 01.Jan.2019

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Relief for MSME Borrowers

Circular dated January 01, 2019

MSME Sector restructuring of advances (in continuation of 07.Feb.18 and 06.Jun.18 circulars)

One time relaxation given for restructuring of MSME standard accounts without downgrade subject to conditions

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Relief for MSME Borrowers

Circular dated January 01, 2019

MSME Sector restructuring of advances (in continuation of 07.Feb.18 and 06.Jun.18 circulars)

1. Aggregate exposures (FB/NFB) of banks and NBFCs should not exceed Rs. 25 crores as on 01.Jan.19

Exposure need not be balance outstanding

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Relief for MSME Borrowers

Circular dated January 01, 2019

MSME Sector restructuring of advances (in continuation of 07.Feb.18 and 06.Jun.18 circulars)

2. Borrower account should be 'Standard Asset' as on 01.Jan.19 and till date of implementation of restructuring

- *An account not marked as NPA but fulfilling NPA criteria to become ineligible*
- *An account which is NPA as on 01.Jan.19 but upgraded subsequently ineligible*

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Relief for MSME Borrowers

Circular dated January 01, 2019

MSME Sector restructuring of advances (in continuation of 07.Feb.18 and 06.Jun.18 circulars)

3. Borrower entity should be registered on the date of implementation of restructuring (except for MSMEs exempt from GST Registration)

A borrower entity can opt for GST registration during the phase of implementation

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Relief for MSME Borrowers

Circular dated January 01, 2019

MSME Sector restructuring of advances (in continuation of 07.Feb.18 and 06.Jun.18 circulars)

4. Restructuring of borrower accounts to be implemented on or before March 31, 2020 subject to fulfilment of specified conditions

No apparent eligibility criteria defined for which accounts can be restructured besides no criteria defined as regards no. of years criteria for restructuring / reschedulement

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Relief for MSME Borrowers

Circular dated January 01, 2019

MSME Sector restructuring of advances (in continuation of 07.Feb.18 and 06.Jun.18 circulars)

5. Additional provision of 5% to be made and retained till end of specified period or account demonstrating satisfactory performance

6. Post restructuring usual NPA norms to apply

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Relief for MSME Borrowers

Circular dated January 01, 2019

MSME Sector restructuring of advances (in continuation of 07.Feb.18 and 06.Jun.18 circulars)

7. Disclosure in Notes on accounts required for MSME restructured accounts specifying no. of accounts and Amount

8. If restructured accounts is downgraded as NPA as per IRAC norms, the same would be eligible for upgradation only if it demonstrates satisfactory performance during the specified period

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Relief for MSME Borrowers

Circular dated January 01, 2019

MSME Sector restructuring of advances (in continuation of 07.Feb.18 and 06.Jun.18 circulars)

Specified period mean a period of 1 year from the date of repayment of interest or principal, whichever is later.

Satisfactory performance means no payment shall be overdue for a period of more than 30 days

Projects under Implementation

Essentials

Project loan means any term loan which has been extended for the purpose of setting up of an economic venture.

The bank needs to clearly spell out 'Date of Completion' (DC) and 'Date of Commencement of Commercial Operations' (DCCO).

Type of Project Loan:

1. Infrastructure Sector
2. Non-Infrastructure Sector

Projects under Implementation

When not considered as Restructuring?

If *change in repayment schedule* is caused due to increase in project outlay on account of increase in scope and size of the project & following conditions are fulfilled:

1. The increase in scope and size of the project takes place before commencement of commercial operations of the existing project;
2. The rise in cost excluding any cost-overrun in respect of the original project is 25% or more of the original outlay;
3. The bank re-assesses the viability of the project before approving the enhancement of scope and fixing a fresh DCCO;
4. On re-rating, (if already rated) the new rating is not below the previous rating by more than one notch.

Projects under Implementation

Deferment of DCCO

If deferent and consequential shift in repayment schedule is for equal or shorter duration, not considered as restructuring if:

Particulars	Infrastructure	Non-Infrastructure
Revised DCCO is within	Two years from original DCCO	One year from original DCCO
Revision due to Court Case	2 + 2 Years from original DCCO	1 + 1 Years from original DCCO
Revision due to any other reason	2 + 1 Years from original DCCO	

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Projects under Implementation

Deferment of DCCO & Retention of Class – Conditions

1. Benefit of asset classification not applicable to CRE
2. Application for restructuring (deferment of DCCO) is received upto to two years from date of original DCCO for Infrastructure and one year w.r.t. non-infrastructure
3. Account needs to be standard
4. If moratorium given for interest, income on accrual can be booked till two years from date of original DCCO for Infrastructure and one year w.r.t. non-infrastructure
5. Additional provision of 5% if extended beyond two years from date of original DCCO for Infrastructure and one year w.r.t. non-infrastructure

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Projects under Implementation

Deferment of DCCO & Retention of Class – Conditions

6. Additional provision of sacrifice (diminishing in fair value) for standard assets is required to be made for extension of DCCO
7. In case of Infrastructure projects under implementation, appointed date is shifted due to inability of concession authority to comply requisite conditions, the loan need not be treated as 'restructuring' provided:
 - i. Project should be Public Private Partnership model
 - ii. Loan is not yet disbursed
 - iii. Revised date is documented by way of supplementary agreement
 - iv. Viability to be re-assessed and sanctioned

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Projects under Implementation

Retention of Class – Change of Ownership (2+2+2)

Additional extension of DCCO permitted upto 2 years with retention of class subject to:

1. Project is stalled due to inadequacies of the promoters;
2. Change of ownership resulting in high probability of commencement of commercial operations;
3. New promoters need to have sufficient expertise
4. New promoters should own at least 51% of paid up equity
5. Viability of the project to be established
6. Intra-group company take over not eligible

Projects under Implementation

Retention of Class – Change of Ownership (2+2+2)

Additional extension of DCCO permitted upto 2 years with retention of class subject to:

7. Asset classification would be as of reference date (date on which preliminary binding agreement is executed)
8. Take over to be completed within 90 days
9. New promoters to demonstrate commitment by bringing in substantial portion of additional funds
10. Repayment schedule not to exceed beyond 85% of economic life
11. Facility available only once

Projects under Implementation

Retention of Class – Financing of Cost Over-runs

Standby Credit Facility:

1. Sanctioned at the time of initial financial closure
2. Purpose is to fund cost overruns, if required
3. To be disbursed only if cost overruns and not otherwise
4. Subsequent Standby Credit facility permitted if DCCO extended upto 2 / 1 year for infra and non-infra
5. Exemption from definition of restructuring provided:
 - i. Interest during construction due to delay can be funded
 - ii. Other cost overruns limited to 10% of original cost

Projects under Implementation

Retention of Class – Financing of Cost Over-runs

Standby Credit Facility:

5. Exemption from definition of restructuring provided:
- iii. Debt / Equity Ratio need to be unchanged (promoters to infuse funds)
 - iv. Disbursement only after promoter's contribution
 - v. No other change in terms and conditions
 - vi. 10% cost-over run ceiling is excluding interest but including currency fluctuations

Income Recognition

For NPA accounts income should be recognised on realisation basis.

When an account becomes non-performing, unrealised interest / fees / commission of the previous periods should be reversed or provided.

Interest income on additional finance in NPA account should be recognised on cash basis.

In project loan, funding of interest in respect of NPA if recognised as income, should be fully provided.

If interest due is converted into (unlisted) equity or any other instrument, income recognised should be fully provided (if listed, income recognised to the extent of MV)

Income Recognition

Order of Recovery

Suggested though not mandatory

- Unrealised Expenses
- Unrealised Interest
- Principal Outstanding

Clarification vide Master Circular - in the absence of clear agreement between the Bank and the Borrower, an appropriate policy to be followed in uniform and consistent manner.

Classification Norms

- **Standard Asset**
The account is not non-performing.
- **Sub-Standard Asset**
A sub standard Asset is one which has remained NPA for a period of less than or equal to 12 months.
- **Loss Assets**
These are accounts, identified by the bank or internal or external auditors or by RBI Inspectors as wholly irrecoverable but the amount for which has not been written off.

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Classification Norms

▪ **Doubtful Asset - Three Categories**

<u>Category</u>	<u>Period</u>
Doubtful - I	Up to One Year
Doubtful - II	One to Three Years
Doubtful - III	More than Three Years

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Provisioning Norms

Primary Responsibility is of the Bank Management and Auditors

Standard Asset	
▪Agricultural and SMEs Sectors	0.25%
▪Commercial Real Estate (CRE) Section	1.00%
▪CRE – Residential Housing Project	0.75%
▪Others	0.40%
▪Housing Loan during teaser rate period	2.00%

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Provisioning Norms

Sub-standard Asset

- 15% of total outstanding
- 25% of total outstanding if loan is unsecured
- 20% of total outstanding if infrastructure loan provided its backed by escrow facility with first charge

Definition of Secured Loan:

If security is not less than 10% of exposure (funded & non-funded) ab initio

Provisioning Norms

Doubtful Assets:

Period Provision (Secured + Unsecured)

Up to 1 year	25%	+	100%
1 to 3 years	40%	+	100%
More than 3 years	100%	+	100%

Loss Asset 100% should be provided for

**Intangible Security: Considered only if backed by legally enforceable and recoverable right over collection and rest of intangibles like rights, licenses, etc. are considered as 'Unsecured'*

Provisioning Norms

Provisioning for Country Risk

In respect of a country where its net funded exposure is ≥ 1% of its total assets

Risk Category	ECGC Classification	Provision % age
Insignificant	A1	0.25
Low	A2	0.25
Moderate	B1	5
High	B2	20
Very High	C1	25
Restricted	C2	100
Off-Credit	D	100

Lower Provision @ 25% w.r.t. short term (180 d) exposures

Provisioning Norms

Provisions under Special Circumstances
Advances under rehabilitation program (BIFR) i. Provision to be continued ii. Eligible for upgradation if renegotiated terms have worked satisfactorily for one year
For Additional facilities, no provision required for one year
Advances guaranteed by CGTSI/ECGC, Provision should be made only for balance in excess of the amount guaranteed by these corporations

Other Aspects

Take out Finance
<pre> graph LR A((Bank - A)) --> B((Bank - B)) B --> C((Bank - C)) </pre>
A typical arrangement with other financier about refinancing of a existing infrastructure loans
If repayment cycle is extended, the account will not be considered as restructuring provided ...
<ul style="list-style-type: none"> ▪ Account should be standard (Project Loan) ▪ Account should not have been restructured in the past ▪ Should have been substantially taken over (> 50%) ▪ Repayment period should be in line with lifecycle of project

Other Aspects

Post Shipment Suppliers' Credit
Exim Bank has introduced Guarantee-cum-Refinance Scheme (Guarantee to settle claim within period of 30 days)
Export Project Finance
The lending bank needs establish through documentary evidence that importer has cleared the dues in full in the bank abroad when its PA

Flexible Structuring of Long Term Infra / Core Industry Project Loan

- Loan Sanctioned after July 15, 2014**
- Clarified that RBI does not have any objection for long term projects in Infrastructure and Core Industries
 - Fundamental viability needs to be established (DSCR)
 - Longer tenure for loan amortisation permitted (e.g.:25 years) provided within useful life and periodic refinancing of balance debt permitted (e.g.: Overall loan tenure is 25 years but initial funding can be for first 5 years and then later balance debt is refinanced)
 - Refinancing Debt facility subject to conditions

Flexible Structuring of Long Term Infra / Core Industry Project Loan

- Conditions for Refinancing Debt facility**
- Only Term Loans to infrastructure and core industries qualify for refinancing
 - Initial appraisal of loan to ensure viability of overall cash flows of the project even during possible stress period
 - Tenor of amortisation should not be more than 80% of initial concession period for Public Private Partnership (PPP) projects / 80% of economic life of the project
 - The initial tenor (of 5-7 years) to cover initial construction period and at least upto date of DCCO
 - If a loan is classified as NPA, eligibility of refinance would be only after its upgraded to PA

Flexible Structuring of Long Term Infra / Core Industry Project Loan

- Loan Sanctioned before July 15, 2014**
- Only to Term Loans to Projects with aggregate exposure of all Institutional Lenders above Rs. 500 crores in Infra / Core industries sector
 - Fresh loan amortisation schedule permissible once in lifetime
 - Not treated as restructuring provided:
 - Loan is standard as on date of change in loan amortisation schedule
 - NPV of revised loan remains same
 - Fresh Loan amortisation period is within 85% of initial concession period for Public Private Partnership (PPP) projects / 85% of economic life of the project
 - Viability is re-assessed and vetted independently

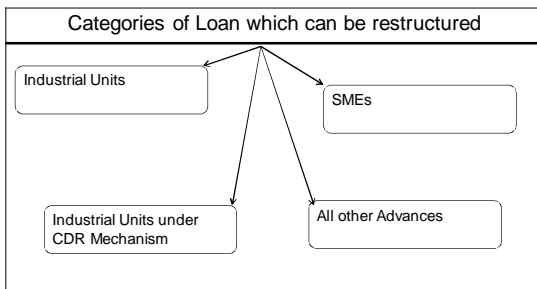
Flexible Structuring of Long Term Infra / Core Industry Project Loan

Exercise of flexible structuring / refinancing should be carried out only after DCCO

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Guidelines on Restructuring of Advances



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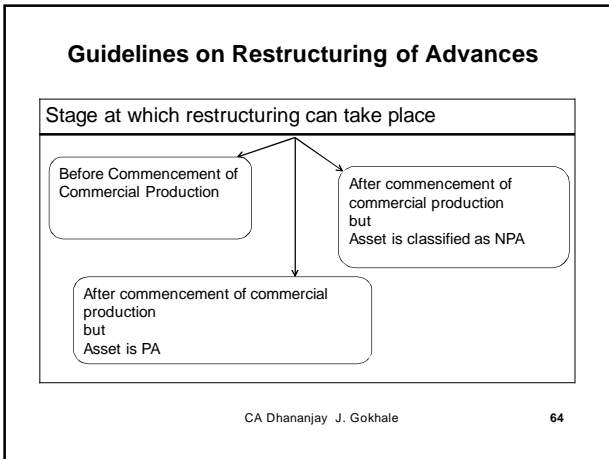
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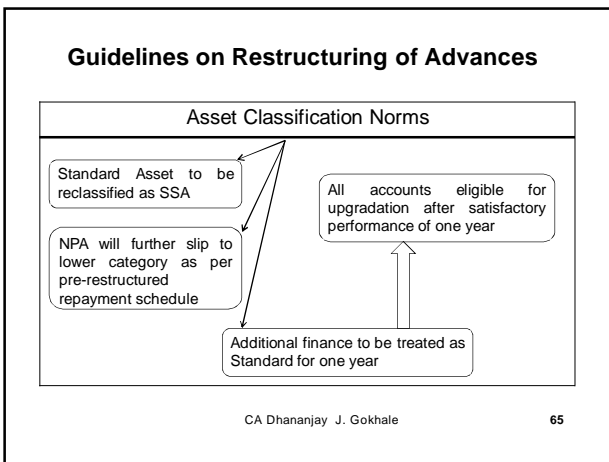
Guidelines on Restructuring of Advances

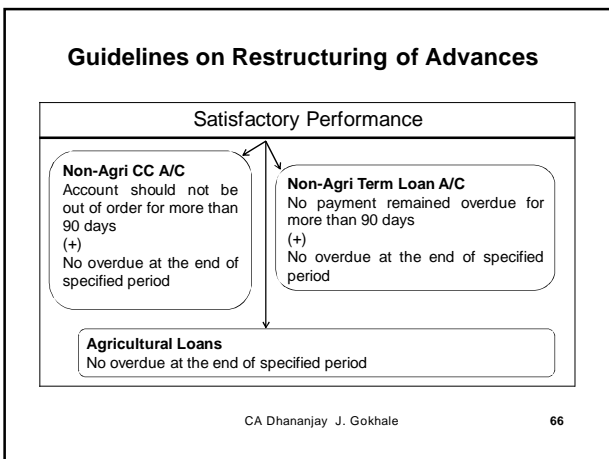
- Eligibility
- Any account classified as standard, sub standard or doubtful.
 - Restructuring cannot be done retrospectively and usual asset classification norms would continue to apply.
 - Restructuring should be subject to customer agreeing to terms and conditions.
 - Financial viability should be established.
 - Borrowers indulging in frauds and malfeasance are ineligible.
 - BIFR cases eligible for restructuring subject to approval from BIFR.

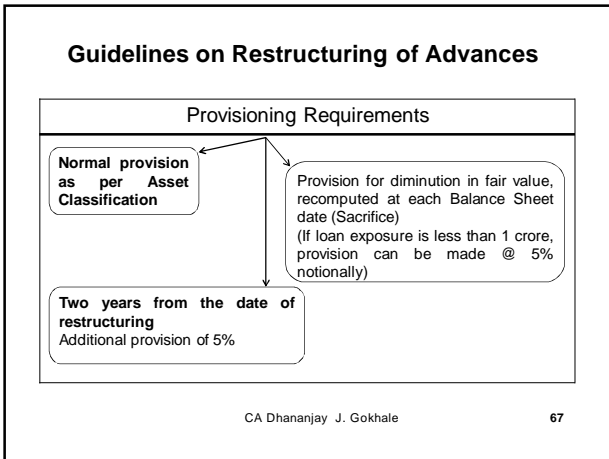
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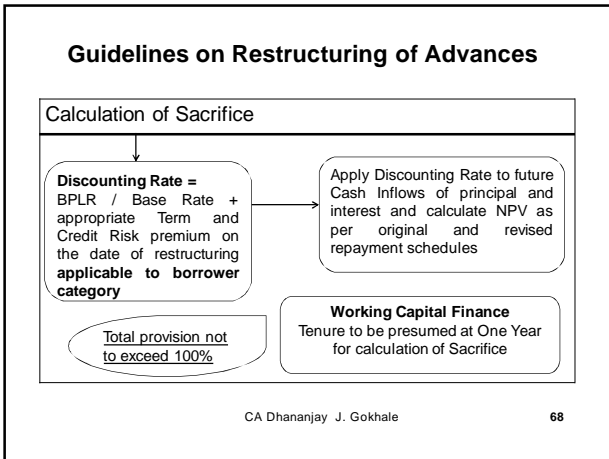
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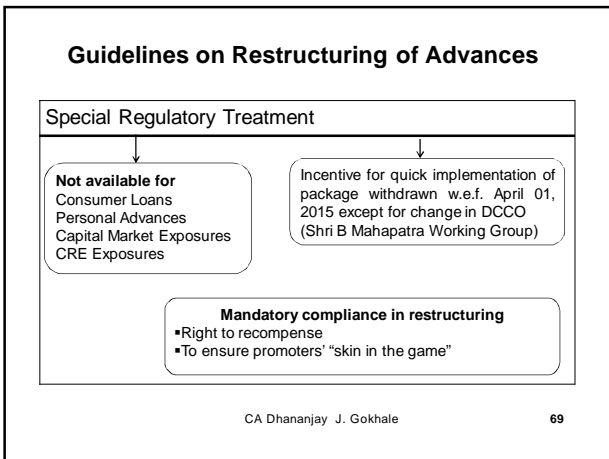












Early Recognition of Financial Distress

Framework of Revitalising Distressed Assets in the Economy (30.Jan.2014)

Setting up of CRILC (Central Repository of Information on Large Credits)

Coverage for Fund and Non-Fund based exposures above Rs. 5 crores excluding crop loans, Inter-Bank / SIDBI / EXIM / NHB / NABARD exposures

Categories	Particulars
SMA 0	Not overdue for more than 30 days but showing signs of incipient stress
SMA 1	Principal / Interest overdue bet. 30-60 days
SMA 2	Principal / Interest overdue bet. 60-90 days

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Early Recognition of Financial Distress

Examples of SMA 0 Incipient Stress

1. Delay beyond 90 days for submission of stock statements / Financial Statements / Renewal of facility
2. Prevention of conduct of stock audit
3. Reduction of DP by more than 20% post-stock audit
4. Actual sales short of more than 40% as compared to projections
5. Return of more than 3 cheques / overdue bills in span of 30 days
6. Devolvement of LC / BG and its non-payment beyond 30 days
7. Third request for extension of time to create security
8. Increase in frequent overdrafts in Current A/C
9. Borrower reporting stress in business / financials
10. Promoters pledging / selling their shares in the borrower company due to financial stress

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Early Recognition of Financial Distress

Formation of Joint Lender's Forum (JLF)

Trigger

- Reporting under SMA 0 for 3 quarters / year
- Reporting under SMA 1 for 2 quarters / year
- Reporting under SMA 2 at any time during the year

Mandatory

If Exposure is above Rs. 100 crores
(inclusion of off-shore lender not mandatory)

Formulation of Corrective Action Plan (CAP)

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Early Recognition of Financial Distress

Corrective Action Plan (CAP)	
Step I Rectification	<ul style="list-style-type: none"> Obtain commitment of identifiable cash flows No sacrifice / loss of lenders Additional finance can be provided but no ever-greening of account
Step II Restructuring	<ul style="list-style-type: none"> Provided its prima facie viable and borrower is not willful defaulter
Step III Recovery	<ul style="list-style-type: none"> If first two options fail, due recovery process to be resorted

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Early Recognition of Financial Distress

Penal Measures for non-adherence of reporting of SMA status to CRILC / Ever-greening of Accounts

Asset Classification	Period of NPA	Current Provisioning	Accelerated Provision
Standard	NA		5%
SSA (Secured)	Up to 6 months	15%	No Change
	6 – 12 months	15%	25%
SSA (Unsecured ab-initio)	Up to 6 months	25% (Other than Infra)	25%
		20% (Infra)	25%
	6 – 12 months	25% (Other than Infra)	40%
		20% (Infra)	40%

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Early Recognition of Financial Distress

Penal Measures for non-adherence of reporting of SMA status to CRILC / Ever-greening of Accounts

Asset Classification	Period of NPA	Current Provisioning	Accelerated Provision
DA – 1	2 nd Year	25% (Secured)	40%
		100% (Unsecured)	100%
DA – 2	3 rd and 4 th Year	40% (Secured)	100%
		100% (Unsecured)	100%
DA – 2	5 th Year onwards	100%	100%

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Early Recognition of Financial Distress

Penal Measures for non-adherence of reporting of SMA status to CRILC / Ever-greening of Accounts
Applicable if the lenders fail to convey the JLF or agree upon common CAP
If escrow maintaining bank does not adhere to terms, lowest NPA status classification amongst the lenders to be adopted

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Early Recognition of Financial Distress

Strategic Debt Restructuring (SDR) Class of Asset Retention permitted
<ol style="list-style-type: none"> 1. Initiative by JLF to change the ownership structure 2. Needs to be agreed upon by at least 75 60% of creditors in value terms and 60 50% in number terms 3. Post-conversion (of debt to equity), all lenders under JLF to hold at least 51% or more of equity shares of the company 4. Can be divested in favor of new promoters subsequently 5. JLF must approve SDR package within 90 days from the date of deciding to undertake SDR 6. Existing asset classification norm as on reference date would be retained for a period of 18 months and then normal IRAC

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Guideline on S4A

Scheme for Sustainable Structuring of Stressed Assets (S4A)
Eligibility
<ol style="list-style-type: none"> 1. Projects commenced commercial production 2. Aggregate exposure (incl. interest) of all institutional lenders is more than Rs. 500 crores 3. Debts meet sustainability criteria <ol style="list-style-type: none"> a. Techno-economic Viability (TEV) study Sustainable debts can be serviced over the same tenor b. Sustainable Debt should not be less than 50% of current funded liabilities

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Guideline on S4A

Scheme for Sustainable Structuring of Stressed Assets (S4A)							
Methodology							
1. Bifurcate current dues into Part A and Part B							
<table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <th style="text-align: left;">Part A</th> <th style="text-align: left;">Part B</th> </tr> <tr> <td>Level of debts that can be serviced based on cash flows available</td> <td>Convert into equity, redeemable cumulative optionally convertible preference shares, Optionally Convertible Debentures</td> </tr> <tr> <td>No Fresh Moratorium to be granted</td> <td></td> </tr> </table>	Part A	Part B	Level of debts that can be serviced based on cash flows available	Convert into equity, redeemable cumulative optionally convertible preference shares, Optionally Convertible Debentures	No Fresh Moratorium to be granted		
Part A	Part B						
Level of debts that can be serviced based on cash flows available	Convert into equity, redeemable cumulative optionally convertible preference shares, Optionally Convertible Debentures						
No Fresh Moratorium to be granted							

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Guideline on S4A

Asset Provisioning (Change in promoters) same as SDR Scheme
Asset Provisioning (No change in promoters)
<ol style="list-style-type: none"> 1. Standstill clause for 90 days from date of lender's decision to resolve account under these guidelines 2. If account is standard, provision to be made lower of 40% of Part B or 20% of overall outstanding 3. If account is NPA, provision as per IRAC norms 4. Lenders can upgrade both Part A and B, subject to satisfactory performance of one year (post-moratorium period) of Part A

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Resolution of Stressed Assets – Revised Framework
Scrapped concepts
<ol style="list-style-type: none"> 1. Corporate Debt Restructuring (CDR) Schemes 2. Strategic Debt Restructuring (SDR) 3. Change of ownership outside SDR 4. S4A 5. JLF concept stands discontinued

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Resolution of Stressed Assets – Revised Framework
Trigger – On default in borrower entity’s account with any lender, all lenders to take steps to cure default by way of Resolution Plan (RP)
<ol style="list-style-type: none"> 1. Regularisation of account by way of overdues repayment 2. Sale of exposure to other entities / investors 3. Change in ownership 4. Restructuring <p><i>Documentation of RP mandatory irrespective of whether there is any change in terms and conditions</i></p>
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Circular dated February 12, 2018

Resolution of Stressed Assets – Revised Framework
Implementation conditions for Resolution Plan (RP)
<ol style="list-style-type: none"> 1. Borrower is no more in default with any lender 2. If RP involves restructuring: <ol style="list-style-type: none"> a. Documentation must be completed by all lenders b. New capital structure / revised terms & conditions of existing loans to get reflected in books of all lenders and borrower c. If exposure is Rs. 100 crores and above Independent Credit Evaluation (ICE) by Credit Rating Agencies (CRAs) {2 CRAs for exposure above Rs. 500 crores} ... rating should be RA4 or better
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Circular dated February 12, 2018

Resolution of Stressed Assets – Revised Framework
When to refer to IBC?
<p>Timelines for implementation of RP for exposures above Rs. 2,000 crores</p> <ol style="list-style-type: none"> 1. If default as on reference date (01.Mar.2018), within 180 days from reference date 2. If default after reference date, then within 180 days from such default <p>If RP is not implemented as above, lenders to file insolvency application within 15 days from date of expiry of 180 days If RP is implemented, the account should not be in default at any time during 'specified period', otherwise file insolvency application within 15 days from date of default</p>
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Resolution of Stressed Assets – Revised Framework

What is specified period?

1. Period from date of implementation of RP upto date by which at least 20% of outstanding principal debt as per RP and interest capitalized as per restructuring is repaid
2. Specified period cannot end before one year from commencement of first payment of interest / principal (whichever is later) on credit facility with longest period of moratorium under RP

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Resolution of Stressed Assets – Revised Framework

Prudential Norms applicable

1. Upon restructuring Standard Assets to be classified as SSA, thus, no retention of class benefit available
2. Upgradation only if satisfactory performance is demonstrated during specified period.
3. If exposure is above Rs. 100 crores, credit rating should be BBB- or above at the end of specified period (Accounts above Rs. 500 crores, would require 2 ratings)
4. Additional Finance to be treated as Standard during specified period, provided the account performs satisfactorily

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Resolution of Stressed Assets – Revised Framework

Prudential Norms applicable

- In case of change of ownership
1. Credit facilities may be continued / upgraded to standard after implementation of change of ownership under RP / IBC subject to certain conditions
 2. Continuation in standard category only if satisfactory performance is demonstrated during specified period

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Resolution of Stressed Assets – Revised Framework

Sale and Lease back transactions

To be treated as restructuring if ...

1. Seller is in financial difficulty
2. More than 50% revenue of buyer is from leased asset to seller
3. 25% or more loan by buyer for purchase of asset are funded by lenders of seller

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Resolution of Stressed Assets – Revised Framework

Refinancing Exposure to Borrowers in different currency

To be treated as restructuring (if borrower is under financial difficulty) if FCY borrowings / export advances for repayment / refinancing of Rupee loans are obtained from:

1. Lender who are part of Indian banking system
2. With support of Indian banking system in the form of Guarantees / Standby Letter of Credit (SBLC) / LoC / LoU, etc.

Circular dated February 12, 2018

Resolution of Stressed Assets – Revised Framework

Non-applicability of guidelines

1. Revival and rehabilitation of MSMEs continued to be guided by circular dated March 17, 2016 (having loan limits upto Rs. 25 crores)
2. Restructuring of loans in the event of a natural calamity shall continue to be as per Master Directions dated July 03, 2017

Guideline on Sale of Financial Asset

Sale of Financial Assets to Securitisation Company (SC) / Reconstruction Company (RC)
Eligibility
<ol style="list-style-type: none"> 1. NPA including non-performing bond / debentures 2. Standard Asset which is under consortium / multiple banking facility: <ol style="list-style-type: none"> i. at least 75% value is classified as NPA ii. At least 75% value of lenders agree to sale-off the asset 3. Asset reported as SMA-2 to CRILC

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Guideline on Sale of Financial Asset

Options
<ul style="list-style-type: none"> ▪ With recourse or without recourse ▪ No operation, legal, or any type of risk related to the asset sold ▪ Drag-along: If 75% of value of borrowers agree, rest are obligated to accept the offer
Consideration Received
<ul style="list-style-type: none"> ▪ Cash ▪ Bonds <i>(to be classified as Investments)</i> ▪ Debentures <i>(to be classified as Investments)</i>

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Guideline on Sale of Financial Asset

Prudential Norms
<ul style="list-style-type: none"> ▪ Shortfall between Net Book Value and sales consideration to be debited to Profit and Loss Account ▪ Sales consideration is lower of Net Book Value and Net redemption Value of the security ▪ If Asset sold between 26.Feb.14 to 31.Mar.16, shortfall may be spread over a period of two years

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Guideline on Sale of Financial Asset

Prudential conditions for purchase / sale of asset

- Sale Price should not be lower than PV of estimated future cash flows associated with the asset
- Estimated cash flows expected to be realised within a period of 3 years
- Bank can purchase / sale NPA from / to other Bank only on 'Without recourse Basis'
- Sale to other bank cannot be made at contingent price
- Sale to other bank only on cash basis
- Purchased asset cannot be re-sold for a period of 15 months

Guideline on Sale of Financial Asset

Prudential conditions for purchase / sale of asset

- Asset to be classified as Standard Asset in purchaser's book for a period of 90 days from the date of purchase
- Borrower-wise classification norms not to apply for these first 90 days
- Reference date of NPA would be the date of NPA of the selling bank
- Restructuring / reschedulement of account by purchasing the account shall render account as NPA

Reiteration of Points

Some important references to RBI Circular

Para 4.2.2 : Banks should establish appropriate internal systems (including technology enabled processes) for proper and timely identification of NPAs, especially in respect of high value accounts.

Para 4.2.5 : If arrears of interest and principal are paid by the borrower in the case of loan accounts classified as NPAs, the account should no longer be treated as non-performing and may be classified as 'standard' accounts

Annex 5 : A restructured account is one where the bank, for economic or legal reasons relating to the borrower's financial difficulty, grants to the borrower concessions that the bank would not otherwise consider.

Recent Developments

Letter of Comfort

Letter of Undertaking

Buyer's Credit

Discontinuation of LoC / LoU for Trade Credits vide circular dated March 13, 2018

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Points to Ponder

Divergences in NPA observed by RBI AFI
Verification Parameters in CBS vis-à-vis RBI Circular
Purity of Master Data in CBS
Reversal of un-serviced Interest of NPA
Availability of valuation of security for advances below 5 crores
Authenticity and regularity of stock statements
Date of NPA – current and prior year of newly identified NPAs
Unique Customer-id of borrower accounts
Accounts upgraded during the year
Regularisation of account subsequent to balance sheet date

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Points to Ponder

Accounts other than Advances accounts including Sundries / Suspense Accounts
Accounts transferred to other branches – control over identification / classification of accounts
Income leakages identified and resulting in overdrawing of accounts
Recalculation of Drawing Power
Early Mortality Cases
Ever-greening of accounts
MOCs vis-à-vis Main Audit Report vis-à-vis LFAR

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Thank you!

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